

## BRIEF IN SUPPORT OF PETITION

### I

#### Legislative History of Section 23(l)

Section 23(l) of the Revenue Acts of 1934 and 1936, here involved, was first enacted by Congress as Section 23(k) of the Revenue Act of 1928, c. 852, 45 Stat. 791.

In presenting the new section, the Senate Finance Committee made the following comment (S. Rep. No. 960, 70th Cong., 1st Sess., p. 20 (1939-1 Cum. Bull. (Part 2) 409, 422-423):

#### SECTION 23 (K) AND (L). DEPRECIATION AND DEPLETION—LIFE ESTATES AND TRUSTS

The House bill makes no change in existing law with respect to these deductions. The committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncertainty and considerable hardship in these two classes of cases under the existing law.

In the case of life tenant and remainderman the bill provides that the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property—that is, in accordance with the estimated useful life of the property—and shall be allowed to the life tenant each year that he holds the property. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the

depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion.

A clerical change is made in section 24(b) of the bill to obviate any conflict between that section and the provisions of sections 23 (k) and 23 (l).

This amendment was adopted and the House Report submitting the Conference Report contains the following (H. Conference Rep. No. 1882, 70th Cong., 1st Sess., pp. 11-12 (1939-1 Cum. Bull. (Part 2) 444, 445):

Amendment No. 30: Under existing law difficulty has been experienced in determining and allowing the deduction for depreciation in cases where property is held by one person for life with remainder to another person; and the deduction, in the case of property held in trust, is allowable only to the trustee. The Senate amendment provides that a life tenant, for the purpose of this deduction, shall be considered as the absolute owner; so that he will be entitled to the deduction during his life, and that thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while

if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion. The Senate amendment provides for an equitable apportionment of the deduction in these cases; and the House recedes.

It appears from the reports of Congress referred to above and the decision of the Board of Tax Appeals in *Sue Carol v. Commissioner, supra*, that Section 23(k) of the 1928 Act was enacted and reenacted as Section 23(l) of the 1934 and 1936 Acts as a relief measure for the benefit of life tenants and life beneficiaries. We think it clear from the legislative history of the pertinent section of the statute that Congress did not intend to limit the deductions for depreciation to which absolute owners or the owners of fee interests have always been entitled. In fact, Congress provided under Section 23(l) that: "In the case of property held by one person for life with the remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant."

If Congress intended to grant depreciation deductions to mere life tenants, we believe it naturally follows that the owner of a greater interest than that of a mere life tenant is entitled to depreciation allowances.

## II

### **The Nature of Petitioner's Interest in the Properties of the Trust Estate**

Under the will here involved the taxpayer was entitled to one-third of the entire net income of the trust for life or until the termination of the trust (R. 28). Upon the

termination of the trust the trustee was required to convey to the taxpayer her one-third interest of the corpus of the trust and any accumulations thereof if living, and if dead, to those she may have by deed or will designated. In addition, the taxpayer had the right under the will of the decedent, Charles Netcher, to dispose of her share of the property by her own will or deed as she desired. Thus the petitioner, having a life interest, plus a remainder interest in the corpus of the trust property, had a fee interest in one-third of the trust property. Section 29.14, Vol. 27, Jones Illinois Statutes Annotated; *Strawbridge v. Strawbridge*, 220 Ill. 61, 77 N. E. 78; *Drager v. McIntosh*, 316 Ill. 368, 38 N. E. 1029; *Melies v. Beatty*, 313 Ill. 418, 145 N. E. 146; *Becker v. Becker*, 206 Ill. 53.

Thus as a holder of a fee simple or interest in one-third of the corpus of the estate, the taxpayer herein is entitled under the statute to her deduction for depreciation on one-third of the trust property.

The Court of Claims held that the petitioner had a one-third interest in the annual net income of the trust and a one-third remainder interest in the trust corpus (R. 34).

In deciding the question of depreciation deductions, the Court of Claims followed the decision of the United States Circuit Court of Appeals for the Seventh Circuit in *Commissioner of Internal Revenue v. Francice Netcher*, 143 F. (2d) 484, certiorari denied October 23, 1944.

It is true that the Case of *Commissioner of Internal Revenue v. Francice Netcher* involved beneficiaries of the same trust estate as is here involved. The taxpayers involved were the children and grandchildren of Charles Netcher, deceased. However, the taxpayers and beneficiaries under consideration by the Court in the *Netcher* case were mere life beneficiaries. The petitioner here, although a beneficiary under the will of Charles Netcher, deceased, had a far greater interest in the trust estate properties

than the life beneficiaries. She had not only a life estate but a remainder interest as well. She was the owner of a fee interest as shown hereinabove. We think that the *Netcher* case is clearly distinguishable from the case at bar because the property interests of the taxpayer involved were entirely different. The beneficiaries in the *Netcher* case held no remainder interests.

We think that the court below erred by ignoring the fee interest of this petitioner and by practically adopting the opinion of the Circuit Court of Appeals in the *Netcher* case involving far different property interests in the same estate.

### III

#### **The Case Involves Important Question of Federal Tax Law**

The decision of the court below has a far reaching effect on depreciation deductions for all trust estates and especially in those cases where beneficiaries have both life and remainder interests and/or legal or equitable fee interests. We think that the decision for the first time denies the holder of an equitable fee interest the right of a deduction for depreciation and that the question is so important to all trust estates that it should be settled by this Honorable Court.

Moreover, we believe that the decision of the court below is not in accordance with the principles enunciated by this Court in *Freuler v. Helvering*, *supra* (291 U. S. 35, 54 S. Ct. 308) and *Helvering v. Falk*, *supra* (291 U. S. 183, 54 S. Ct. 353). We also believe that the decision of the court below conflicts in principle with *Commissioner v. Gutman*, *supra* (C. C. A. 2, 143 F. (2d) 201) and the decision of the Court of Claims itself in *Chisholm v. U. S.*, *supra*, 85 Ct. Cl. 199, 19 F. Supp. 274.

In the above mentioned cases mere life beneficiaries were allowed deductions for depreciation or depletion, whereas the taxpayer in the case at bar had a life estate plus a remainder interest in one-third of the corpus of the estate property.

Respectfully submitted,

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## APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

Sec. 23. *Deductions from gross income.*

In computing net income there shall be allowed as deductions:

\* \* \* \* \*

(1) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

Similar provisions are contained in Section 23(1) of the Revenue Act of 1934, c. 277, 48 Stat. 680.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

Art. 23 (1)-1. *Depreciation.*— \* \* \* In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is

allocable to the trustees and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

Similar provisions are contained in Article 23(1)-1 of Treasury Regulations 86, promulgated under the Revenue Act of 1934.

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